ROYAL COMMISSION REPORT - LIFE INSURANCE AND GENERAL INSURANCE

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By: Jim Bulling

The Final Report of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* was released on 4 February 2019. In addressing the findings from hearings into the insurance industry, Commissioner Kenneth Hayne made several recommendations for the government to consider and implement into law. These recommendations pave the way for the future of regulation in the industry.

1. RECOMMENDATIONS

1.1. No hawking of insurance

The Commission examined the unsolicited offers and sales of insurance following ASIC's conclusion that such unsolicited sales are 'commonly associated with poor sales conduct and increase[d] the risk of poor consumer outcomes'.

ASIC's findings were confirmed in the Freedom and ClearView case studies. Hayne found that remuneration incentives and a disregard for the vulnerable led sales agents to offer complex financial products (often forcefully) to individuals who had not turned their minds to, and did not have adequate information about what value the product has for them.

Accordingly, the Final Report recommended prohibiting the unsolicited offer or sale of insurance products, except to those who are not retail clients and except for offers made under an eligible employee share scheme.

1.2. Removing the exemptions for funeral expenses policies

The Commission saw no justification for providers of funeral expenses policies to be exempt from the requirement to possess an AFSL. Hayne noted that all forms of funeral insurance should be subject to the same regulatory regime and supervision. He also expressed concern that funeral expenses policies contained a lack of value for customers.

Therefore, it was recommended that the law should be amended to:

- remove the exclusion of funeral expenses policies from the definition of 'financial product', and
- put beyond doubt that the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) apply to funeral expenses policies.

1.3. Add-on insurance

a) Deferred sales model

The Commission responded to ASIC's concerns that add-on insurance products expose consumers to unfair sales tactics and adverse outcomes. The IAG case study highlighted that motor dealers are incentivised to sell as many add-on insurance products to consumers as possible, regardless of their suitability or value to customers.

Consequently, it was recommended that add-on insurance should generally be sold under a deferred sales model, (except policies of comprehensive motor insurance). Under this model, insurers or their representatives would be required to wait for a specified period of time before attempting to sell add-on insurance products to their customers.

A deferred sales model inserts a pause into the sales process and is designed to give consumers additional time to navigate the complexities of add-on products and thereby facilitate improved decision making.

b) Cap on commissions – sale of a motor vehicle

Evidence given to the Commission demonstrated that the high levels of commissions paid to motor vehicle dealers in connection with the sale of add-on insurance products contributed to the mis-selling of those products. In the 2015 financial year, ASIC found that the commission paid to dealers for the sale of these insurance products were as high as 79% of the premium.

Accordingly, it was recommended that ASIC should impose a cap on the amount of commission that may be paid to vehicle dealers in relation to the sale of add-on insurance products.

1.4. Pre-contractual disclosure and representation

a) Duty to take reasonable care not to make a misrepresentation to an insurer

Currently, in consumer insurance contracts, the individual seeking insurance has a duty to disclose any matter relevant to the decision of the insurer on whether to accept the risk. Hayne noted that a duty framed in this way fails to recognise that insurers are always better placed than an insured to identify the categories of information that they consider to be relevant to their decision of whether to insure a risk.

Consequently, the Final Report recommended that the duty of disclosure be replaced with a duty not to make a misrepresentation to the insurer. As a result the burden is placed on the insurer to elicit information that the Insurer needs in order to assess whether it will insure a risk and at what price.

b) Avoidance of life insurance contracts

Section 29(3) of the *Insurance Contracts Amendment Act 2013 (Cth)* has been understood as expanding the circumstances in which an insurer could avoid a contract of life insurance. The removal of the words 'on any terms' means that a life insurer now can avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if the Insurer can show that it would not have entered into *the same* contract.

The TAL case study demonstrated that the amendment of s 29(3), provided scope for insurers to use inappropriate conduct including the engagement of, and inappropriate use of external investigators; the excessive use of surveillance; bullying tactics and offensive communications in order to avoid paying an insurance claim.

Therefore, Hayne recommended that the position prior to section 29(3) be restored, so that an insurer may only avoid a contract of life insurance on the basis of non-disclosure or misrepresentation if the Insurer can show that it would not have entered into a contract on *any* terms.

1.5. Unfair contract terms

The Commission found that the rationale for an unfair contract regime for financial products and services apply equally to insurance contracts, a conclusion echoed by the Treasury.

Consequently, Hayne recommended that the unfair contract terms provisions now set out in the ASIC Act should apply to insurance contracts regulated by the *Insurance Contracts Act 1984 (Cth)*.

1.6. Claims handling

The handing and settlement of an insurance claim is currently carved out from the definition of 'financial service' in the *Corporations Act 1989 (Cth)* (Corporations Act). Therefore, the obligation to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly, do not govern the ways in which insurers make a decision about a claim or conduct negotiations in respect of settlement amounts.

In Hayne's view there is no basis in principle for continuing to exclude claims handling from the definition of 'financial service'. As endorsed by ASIC, the intrinsic value of an insurance product for consumers lies in the ability to make a successful claim when an insured event occurs.

Accordingly, the Final Report recommended that the handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of 'financial service'.

1.7. Status of industry codes

Hayne recognised the limitations of self-regulation in the insurance industry including that:

- the standards set may not be adequate;
- not all industry participants may subscribe to, and be bound by, the code;
- monitoring and enforcement of compliance with the code may be inadequate; and
- the consequences for breach of the code may not be enough to make industry participants correct and prevent systemic failures in its application.

To overcome the above difficulties the Commissioner recommended that some provisions of industry codes be made 'enforceable code provisions' by 30 June 2021. This will ensure that a breach of those provisions will constitute a breach of the law.

Furthermore, Hayne recommended amendments to the Life Insurance Code of Practice to empower the Life Code Committee or the Code Governance Committee to impose sanctions on a subscriber that has breached the applicable Code.

1.8. External dispute resolution

The case studies including TAL and AAI demonstrated problematic dealings between an insurer and the external dispute resolution body, the Australian Financial Complains Authority (AFCA). Hayne noted that currently the Corporations Act does not impose any conduct-related obligations on AFSL holders when dealing with the AFCA and therefore he saw little benefit in mandating the existence of systems if there is no obligation to comply with the external body.

Accordingly, Hayne recommended that section 912A of the Corporations Act be amended to require that AFSL holders take reasonable steps to co-operate with the AFCA in its resolution of particular disputes including, in particular, by making available to the AFCA all relevant documents and records relating the issues in dispute.

1.9. Accountability

Over time, that the provisions modelled on the Banking Executive Accountability Regime (BEAR) should be expanded to all APRA regulated financial services institutions.

1.10. Group life insurance

a) Universal terms review

The Commissioner noted that insurance contracts can often be difficult for the average consumer to navigate and understand with subtle differences in definitions, terms and exclusions from one policy to another making the task of comparing policies challenging. Further, when a member chooses the fund or product it will usually be for the member alone to form a view about the merits of the product and the insurance offered through it.

Accordingly, it is recommended that Treasury, in consultation with industry, should determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies.

b) Additional security for related party engagements

The Commissioner stated that potential conflicts may arise where related parties are engaged in the context of group life insurance. Hayne noted that entities that elect to integrate their business do so overwhelmingly for their own profit-making purpose rather than consumer benefit.

Consequently, it is recommended that APRA should amend Prudential Standard SPS 250 to require RSE licensees that engage a related party to provide group life insurance, or who enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, to obtain and provide to APRA within a fixed time, independent certification that the arrangements and policies entered into are in the best interests of members and otherwise satisfy legal and regulatory requirements.

c) Status attribution to be fair and reasonable

ASIC reported that on transferring members from an employer plan to a personal plan within the same superannuation fund, some trustees were automatically classifying members as 'smokers' or 'blue-collar workers' unless they received specific information from the member to the contrary.

Accordingly, the Commission recommended that APRA should amend Prudential Standard SPS 250 to require

RSE licensees to be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable.

2. FURTHER CASE STUDIES

2.1. Misleading and deceptive statements

Allianz

In 2016, Allianz conducted a review of the website and found a number of misleading and deceptive statements. These statements remained on the website for a further 12 months and during this period, Allianz issued two million travel insurance policies.

The number of misrepresentations on Allianz's website and the time it took to remedy them gave rise to a significant breach that was not reported. As a result, the commission referred the conduct to ASIC.

AAI

In May 2015, six months prior to the Wye River bushfires, AAI ran a direct mail campaign and published representations on its website stating that it would cover rebuilding of its insured's homes, "*no matter the cost to us*". However, these representations were untrue because:

- AAI could choose to provide a cash settlement instead; and
- there were cost limits both in terms of the costs that AAI felt was fair and reasonable in relation to the scope of work, and from the requirement that AAI was to repair or rebuild on a 'new for old' basis.

As a result ASIC issued four infringement notices to AAI relating to AAI's representations.

2.2. Handling of insurance claims

Youi

When dealing with a home insurance claim in January 2017, Youi selected a builder to undertake repairs despite being aware of numerous complaints about the builder. After deciding that the builder had broken the law, Youi did not allocate the repairs to another builder nor tell the claimant about the issues.

When the builder walked off the job (due to a payment dispute) leaving the claimant with no roof and no air-conditioning, "make safe" works were arranged but no steps were taken by Youi to check that the works actually occurred and the claimant was safe.

Hayne found it arguable that Youi may have breached its duty of utmost good faith to the claimant and referred the conduct to ASIC.

2.3. Design of insurance products

(a) Definitions

An insurer's life insurance policy contained a definition of 'heart attack' from 2012 to 2016 that the insurer knew:

- did not reflect the universal generally accepted definition of 'heart attack';
- might have required troponin I levels 20 times higher than those required under the universal definition of 'heart attack'; and
- could discriminate against the insurer's female customers, as it was less common for women to reach the troponin I level specified in the definition.

The insurer acknowledged that their delay in updating the definition of heart attack fell below community expectations. Furthermore, the material on web pages and brochures made available by the insurer did not sufficiently qualify that consumers would need to satisfy the 'heart attack' definition. As a result, the insurer and the Commissioner agreed the insurer had engaged in misleading and deceptive conduct.

3. GOING FORWARD

The recommendations made by the Royal Commission acknowledge that insurance, as a means of spreading risk creates benefits for both individuals and for communities. However, Hayne concluded that changes to insurance regulation needs to be made to bring the regulation into line with that of other financial products, and to better balance the rights and obligations of insurers and insureds.

Further, the Commission heavily focused on ensuring that insurers' future conduct does not fall below community expectations and insurance products always offer value to consumers. This is likely to be a theme in the future regulation and enforcement of the insurance industry.

Both ASIC and APRA have been heavily criticised for their unwillingness to bring breaches of law to court, instead opting for negotiations and placing reliance on agreed penalties and enforceable undertakings. Therefore, we anticipate that ASIC and APRA will feel compelled to initiate civil proceedings against insurers when they detect or are notified of a breach of the law.

We are recommending that all insurers begin the process of preparing for a new regulatory environment. At the very least, insurers should, as a starting point:

- familiarise themselves with the recommendations;
- closely monitor any developments from government and regulators; and
- consider how they would implement measures in order to comply with each of the Commissioner's recommendations and the more aggressive enforcement attitude from ASIC.

If you would like to discuss the findings by the Commissioner in the Final Report and its potential impact on your business activities, please contact Jim Bulling on (03) 9640 4338 or Daniel Knight on (03) 9640 4324 for further detail.

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